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SUBJECT: TURKMENISTAN 2008 INVESTMENT CLIMATE REPORT

11. (U) Text of Embassy Ashgabat's Investment Climate Statement for 2008 is as follows:

BEGIN TEXT:

OPENNESS TO FOREIGN INVESTMENT

Turkmenistan is a relatively large but sparsely inhabited country (about five million) with abundant hydrocarbon resources. The government regularly proclaims its wish to attract foreign investment, but its state-control mechanisms and restrictive currency-exchange system have created a difficult foreign-investment climate. Historically, the most promising areas for investment are in the oil and gas, agricultural and construction sectors. Even in these areas, companies must conduct extensive due diligence. The lack of established rule of law, inconsistent regulatory practices, and unfamiliarity with international business norms are major disincentives to foreign investment. Although President Gurbanguly Berdimuhamedov has expressed his intent to improve investment conditions, to date he has taken no specific related actions.

Turkmenistan's economy depends heavily on production of natural gas, oil, petrochemicals and, to a lesser degree, cotton and textiles. The country is the second largest gas producer in the former Soviet Union. All other existing industrial production, with the exception of food processing, needs substantial development. The country's key industries are still state-owned. According to independent estimates (European Bank of Reconstruction and Development EBRD Transition Report 2007), the private-sector share in GDP in 2006 was 25%, mostly concentrated in retail trade, services and food processing.

The top economic development priority of the Government of Turkmenistan since independence in 1991 has been self-sustainability in food supplies and an increase in import-substituting production using hydrocarbon revenues. Other industries where the government has been most receptive to foreign investment are the textile and construction sectors, which all acutely need modern technology,

knowledge of international markets and experience in international business practices. All investment proposals are screened for compliance with these government priorities. The national program entitled "Economic, Political and Cultural Development Strategy for Turkmenistan to 2020" specifies government plans for the petroleum, chemical, power generation, mining, metallurgy, textiles, construction, agriculture, transportation, communication and other industries. In October 2006, Turkmenistan adopted the Oil and Gas Development Plan for 2007-2030.

Turkmenistan has a closed investment climate. Decisions to allow foreign investment are politically driven; companies from "friendly" countries are more successful in winning tenders and signing contracts. The country has significantly reduced its foreign borrowing, particularly from international donor organizations, because of leadership fears that overseas loans may lead to political dependency on foreign states. However, since independence, Turkmenistan has accepted financing from IFIs for a variety of projects. In this environment, where the government selectively chooses its investment partners, a strong relationship with the government is essential. Often, government officials expect personal gain for allowing or helping foreign investors enter the local market. One way to penetrate the market has been to work through established foreign businessmen, who arrange deals through their personal relationship with top leaders, or via high-ranking foreign officials. Preliminary indications seem to demonstrate that establishing a personal relationship with the new president will remain the most direct -- and in some cases, the only -- way to gain entry to Turkmenistan's market.

Incoming foreign investment is regulated by the Law on Foreign Investment (last amended in 1993), the Law on Investments (last amended in 1993) and the Law on Corporations of 1999, with respect to start-up corporations, acquisitions, mergers and takeovers of

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corporations. Foreign-investment activities are affected by appropriate bilateral or multilateral investment treaties, the Law on Enterprises of 2000, the Law on Business Activities (last amended in 1993), and the Land Code approved in 2004. Foreign investment in the oil and gas sector is subject to the 1996 Petroleum Law (last amended in December 2005). The Tax Code provides the legal framework for the taxation of foreign investment. The 2000 Civil Code defines what constitutes a legal entity in Turkmenistan, as well as requirements for registration. Much foreign investment is governed by project-specific presidential resolutions, which may grant privileges not provided by the general legislation.

Legally, there are no limits on foreign ownership or control of companies. In practice, the government has allowed fully-owned foreign operations only in the oil sector and, in one case, in cellular communications (MTS of Russia). There are various ways for the government to discriminate against disfavored foreign as well as domestic investors: excessive tax examinations, license extension denial, and customs clearance and visa issuance obstacles. Starwood Hotels and Resorts operated two Sheraton-franchise hotels in Ashgabat, but left Turkmenistan in 2006 as a result of disagreements over interpretation of its contract with the government.

In most cases, the government has insisted on maintaining a majority interest in any joint venture (JV). Foreign investors have been reluctant to enter JVs controlled by the government, as a result of competing business cultures and conflicting management styles. Foreign investors may only sell shares or divest with government permission, although there is no specific legislation. Coca-Cola Bottlers has been in Turkmenistan since the mid-1990s in a JV with the government.

Government efforts since 1991 to privatize former state enterprises have attracted little foreign investment. Privatization has been limited to the service and trade sectors, with most industry still in state hands. Out-dated technology, poor business structures, and governmental obstacles make privatized firms unattractive as outright purchases for foreign investors. To date, government privatization efforts have also been counteracted by lingering prejudice against the private sector. In cases where there is

income potential, the government has been quick to crowd out the private sector as a competitor.

All land is government-owned. Neither domestic nor foreign entities can receive long-term land-use rights for "non-agricultural" purposes. Private citizens have land rights under specific circumstances. However, these rights exclude the sale or mortgage of land. Land rights can only be transferred through inheritance. Foreign companies or individuals are permitted to lease land for non-agricultural purposes, but only the president has the authority to grant the lease.

The government has attempted to introduce an element of competition for state contracts by announcing international tenders for some projects. In many cases, Turkish companies have been hired to act as advisors in the tender process. Typically, these projects are politically motivated and/or economically unsound, and the tender process is badly managed and often not transparent, timely, well-prepared, or accessible. Following the president's announcement of a potential project, interested foreign investors and/or suppliers often contact the relevant government agency directly in case the tender is not announced publicly. There is one case of a U.S. company being told it was awarded a tender, investing in initial project design, and then being informed the government was considering other options. The tender was offered a second time, and the contract was awarded to a new company at double the U.S. company's tender price. Investors should always put agreed-upon terms in writing and never act on verbal promises.

Turkmenistan signed a Trade and Investment Framework Agreement (TIFA) with the United States, Kazakhstan, Tajikistan, Kyrgyzstan, and Uzbekistan on June 1, 2004. The TIFA established a regional

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forum to discuss ways to improve investment climates and expand trade within Central Asia. However, the Government of Turkmenistan does not actively engage in regional efforts aimed at boosting investment projects. Turkmenistan sells electricity to Afghanistan at subsidized rates

Since independence in 1991, Turkmenistan has received an estimated \$2.86 billion in foreign direct investment (FDI) (EIU Turkmenistan Country Report, October 2006). In October 2006, the Government stated that Production Sharing Agreement (PSA) operators (Petronas, Burren Energy, Maersk/Wintershall Consortium, Mitro International of Austria/Turkmennebit Consortium) had invested \$1.34 billion in their local operations. The EBRD Transition Report Update (May 2006) projected net FDI for 2006 to total \$308 million.

CONVERSION AND TRANSFER POLICIES

The Government of Turkmenistan maintains tight control over the country's main foreign-exchange flows. There are two de facto exchange rates. The official rate has remained fixed at 5,200 manats per dollar since 1998; for the last three years the unofficial rate has hovered around 24,000 manats per dollar. By presidential decree, as of January 1, the "unofficial" exchange rate can be no higher than 20,000 manats/dollar. In the latter part of 2006, benefiting from the steady flow of natural gas and oil income, the government began to allow banks to convert manats from some commercial entities at a near-unofficial rate of 22,800 manats per dollar. Foreign bankers considered this newly-permitted currency-exchange system to be a modest step towards overall liberalization of the foreign exchange market. The Central Bank is known to control the unofficial rate by releasing large quantities of U.S. dollars into the unofficial (but legal) exchange market.

In November 2007, President Berdimuhamedov announced his intention to unify the exchange rate by 2009. The Government of Turkmenistan also plans to release new, redenominated currency at that time. In preparation for exchange rate unification, Berdimuhamedov has stated that Turkmenistan will seek advice from international financial institutions.

Oil producers operate under the Petroleum Law and receive their profit share in crude oil, which they ship by tankers to other

Caspian Sea littoral states or swap in Iran or Persian Gulf countries. In many cases, investors in petrochemicals have negotiated deals with the Government of Turkmenistan to recoup their investment in the form of future petroleum products. Foreign investors generating revenue in foreign currency, such as textile factories, do not generally have problems with repatriating their profits. However, some foreign companies receiving income in local currency, such as Coca-Cola, seek indirect ways to convert local currency to hard currency through the purchase of petroleum and textile products in manat for resale on the world market.

Turkmenistan imports the vast majority of its industrial equipment and consumer goods. The government's foreign-exchange reserves pay for this industrial equipment and various investment projects. The demand for hard currency in Turkmenistan's private retail sector seems to be satisfied by the unofficial but legal exchange market and the newly-introduced possibility to also buy dollars in banks at the "near-unofficial" rate.

EXPROPRIATION AND COMPENSATION

Turkmenistan's legislation does not provide for private ownership of land, and thus offers opportunities for the government to force investors to vacate their land. Article 21 of the Investment Law allows investors' property to be confiscated by a court decision. Although there have been no reported expropriatory actions against foreign investors in the last year, the Government of Turkmenistan has a history of arbitrary expropriation of the property of local businesses and individuals. Under the previous leadership, the government often refused to pay any compensation, much less fair market value, when exercising "the right of eminent domain." For example, as part of a "city beautification" project to widen

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Ashgabat's streets, hundreds of homes and some local businesses were destroyed. Homeowners were given short notice and little, if any, compensation for loss of their dwellings. However, during a March 2007 Cabinet of Ministers meeting, President Berdimuhamedov stated that residents of affected apartments or houses would be provided with alternative housing before their homes are demolished. In 2007, neighbors who were promised housing six months after their apartments were to be destroyed appealed to international organizations in order to obtain new housing immediately, and were given new apartments shortly thereafter.

DISPUTE SETTLEMENT

Most contracts negotiated with the government have an arbitration clause. Embassy strongly advises U.S. companies to include an arbitration clause with a venue outside Turkmenistan.

There have been several commercial disputes over the past few years involving U.S. and other foreign investors or contractors in Turkmenistan, though not all the disputes were filed with arbitration courts. Turkmenistan's investment and commercial disputes have three common themes: non-payment of debts, non-delivery of goods or services, and contract renegotiations. The government may claim the provider did not meet the terms of a contract as justification for non-payment. Most disputes have centered on the government's unwillingness to pay in hard currency as contractually required. In cases where government entities have not delivered goods or services, the government has often ignored demands for delivery. Finally, a change in the leadership of a government agency that signed the original contract often triggers a government call to re-evaluate an entire contract, including profit distribution, management responsibilities and payment schedules.

A western oil and gas company and Turkmenneft, the government-owned oil company, have been in litigation since 1996. Under the auspices of the International Chamber of Commerce, in 2001 the western company was awarded of \$495 million in damages. In spring 2006, the U.S. Court of Appeals upheld the 2001 decision and bound the Government of Turkmenistan to an arbitral award rendered by a tribunal sitting in Houston, Texas, in favor of a foreign party against State Concern Turkmenneft. In November 2006, the U.S. Supreme Court denied Turkmenistan's petition for a writ of certiorari. The award has not been paid.

Although Turkmenistan has adopted a number of laws designed to regulate foreign investment, the laws have not been consistently or effectively implemented. The concentration of power in the office of the president has undermined the rule of commercial law. Legislation is regularly made -- or overturned -- by presidential decree. The Law on Foreign Investment, as amended in 1993, is the primary legal instrument defining the principles of investment. The law also provides for protection of foreign investors. The foreign investor is defined in the law as an entity owning a minimum average of 20% of a company's assets during a calendar year, unless the Cabinet of Ministers waives the requirement.

The following is an ad hoc list of relevant legislation regarding foreign investments:

- All foreign and domestic companies and foreign investments must be registered at the Ministry of Economy and Finance (MOEF).
- The Petroleum Law (Law on Hydrocarbon Resources) regulates offshore and onshore petroleum operations in Turkmenistan, including petroleum licensing, taxation, accounting and other rights and obligations of state agencies and foreign partners. The Petroleum Law supersedes all other legislation pertaining to petroleum activities, including the Tax Code.
- According to the Land Code, foreign companies or individuals are permitted to lease land for non-agricultural purposes, but only the president has the authority to grant the lease. Foreign companies may own real estate property other than land.
- Turkmenistan adopted a Bankruptcy Law in 1993.

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- Other laws affecting foreign investors include the Law on Investments (last amended in 1993), the Law on Corporations of 1999, the Law on Enterprises of 2000, the Law on Business Activities (last amended in 1993), the Civil Code enforced since 2000, and the Law on Property of 1993.

The commercial-law enforcement system includes the Arbitration Court of Turkmenistan (Arachy Kazyyet) which tries 13 categories of disputes, both pre-contractual and post-contractual, including taxation, legal foundations and bankruptcy issues. The court does not interfere in enterprises' economic relations, but considers disputes by request from either party involved. Appeals on decisions of the Arbitration Court can be filed at the Arbitration Committee of the Supreme Court of Turkmenistan.

Turkmenistan has not become a Party to the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (also known as the Washington Convention) or the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards or any other internationally recognized arbitration agreement.

PERFORMANCE REQUIREMENTS/INCENTIVES

Foreign investors are disadvantaged by higher tax rates than most local companies. The Tax Code adopted in 2004 was amended three times, in 2005, 2006 and 2007, but with most tax rates remaining unchanged. The Value Added Tax is 15%, an income tax of 8% is applied to JVs and an income tax of 20% to wholly-owned foreign companies and state-owned enterprises. Dividends are taxed at 15%, and the personal income tax is 10%. In 2005, the government of Turkmenistan amended the tax code, giving more concessions to domestic private companies. The Code exempted domestic private companies from the VAT and property tax and reduced the income tax from 8% to 2%. In August 2006, Turkmenistan increased its excise tax on imported beer (50%) and wine (100%). Similar taxes on domestically produced beer and hard liquor remain at previous rates: 10% and 15%-40% respectively.

In May 2007 Turkmenistan introduced a National Tourism Zone (NTZ) to promote tourism development on the Caspian Sea coast. Tax and other incentives are provided in the new legislation passed on October 1, but only to those willing to invest in construction of hotels and recreational facilities. The amendments to the Tax Code passed on October 1 exempt construction and installation of tourist facilities in the NTZ from the VAT. Various services of tourist facilities,

including catering and accommodation, are also VAT-exempt. Income tax on accommodation and catering of tourist facilities will not be levied for the first 15 years.

Equipment purchased by the investor as part of the registered capital, other assets to be used in production, and personal household effects of investors' employees are duty free.

Tax and investment incentives can be negotiated on a case-by-case basis. The president has often issued special decrees granting taxation exemptions and other privileges to specific investors while recouping the initial investment.

Assets and property of foreign investors should be insured with the State Insurance Company of Turkmenistan (Article 53 of the Petroleum Law, Article 3 of Insurance Law). National accounting and financial reporting requirements also apply to foreign investors. All contractors operating in Turkmenistan for a period of at least 183 days a year must register at the Main State Tax Service. There is a general requirement for foreign investors that 70% of the company's personnel be local. The government can make exceptions for foreign construction companies executing large-scale turnkey projects. Turkmenistan requires that all export and import contracts and investment projects be registered at the State Commodity and Raw Materials Exchange (SCRME) and the Ministry of Economy and Finance. The procedure applies not only to the contracts signed at the SCRME, but also to contracts signed between third parties. The SCRME is

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government-owned and is the only exchange in the country. The contract registration procedure includes an assessment of "price justification." All import contracts must be registered before goods are delivered to Turkmenistan.

The government mostly favors long-term investment projects that do not require regular hard-currency purchases of raw materials from foreign markets. Textile factories operated by Turkish companies using domestic resources and labor serve as model investment projects supported by the government. These companies encounter relatively few currency conversion problems and enjoy tax holidays. Otherwise, there are no set requirements for local sourcing or exporting specific percentages of output.

Production Sharing Agreement (PSA) holders are mostly regulated by the Petroleum Law. They are subject to a 20% income tax and royalties ranging from 1% to 15%, depending on the level of production. The social welfare tax, 20% of the total local staff payroll, is also payable by all foreign investors and their subcontractors. PSA holders' employees and their subcontractors pay a personal income tax of 10%. Under the Petroleum Law, PSA concessions have been made to six foreign energy companies: three offshore and three onshore concessions for 20-25 years. Five of the existing concessions are in the oil sector and one in the gas sector.

Subcontractors of PSA holders can bring their equipment into the country only for a duration of a valid contract. There is no appropriate legislation that regulates operations of oil and gas subcontractors

Currently, Turkmenistan lists 94 import and nine export goods and materials subject to customs duties. Goods and materials not on the lists are subject to a 5% customs duty payment. In regard to exports, customs maintains a list of goods subject to customs duty payment. Export of fertilizers, non-ferrous metals, their alloys, and products made of non-ferrous metals is prohibited. State enterprises often receive preferential treatment; for example, wool carpets produced at state factories are exempt from customs duties. In contrast, private carpet producers have to pay 100% customs duties for exporting carpets.

Foreign investors are required to adhere to the sanitary and environmental standards of Turkmenistan. Foreign investors' products should be of equal or higher quality than prescribed by the national standards.

Turkmenistan, while not a member of the World Trade Organization

(WTO), has enacted a number of laws in key areas relevant to the WTO: investment, banking, intellectual property rights, customs, and privatization. However, the legislation is not enforced uniformly. Turkmenistan is not a signatory to and is not in compliance with the Agreement on Trade-Related Investment Measures (TRIMS).

The State Service for Registration of Foreign Citizens was created in 2003 with the specific aim of controlling access to the country and movement of foreign citizens within Turkmenistan. All visitors are required to register upon entry, and travel to most border areas requires a special permit. Inviting foreigners often is problematic, because authorities can and do deny entry visas without explanation. With these travel strictures, foreign investors trying to enter Turkmenistan for the first time have difficulty obtaining entry visas unless invited by the government. Even established investors continue to complain about bureaucratic procedures and delays in this context.

RIGHT TO PRIVATE OWNERSHIP AND ESTABLISHMENT

Foreign and domestic private entities in Turkmenistan have the right to establish and own business enterprises, though this is associated with onerous bureaucratic requirements. The 2000 Law on Enterprises

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establishes state and private businesses in various legal forms (state enterprises, sole proprietorships, cooperatives, partnerships, corporations and enterprises of non-government organizations). The law allows foreign companies to establish subsidiaries, but the Government does not currently register subsidiaries. The Civil Code of Turkmenistan and the Law on Enterprises provide for representative and branch offices to operate in Turkmenistan; these offices do not have legal entity status, but have to be registered at the Ministry of Economy and Finance.

The government prohibits engagement in certain areas of commercial activity, such as mass media. The 1999 Law on Licensing Certain Types of Activities lists 65 types of activities that require government licenses. Currently, state entities do not require licenses. Often private entities need to do more than public enterprises to access markets and credit.

The Law on Enterprises and the Law on Corporations provide for acquisitions and mergers. However, Turkmenistan's legislation is not clear about acquisitions and mergers involving foreign parties, nor does it have specific provisions for disposition of interests in business enterprises, both local and with foreign participation. Government approval is necessary for acquisitions and mergers of certain enterprises, specifically those with state shares.

PROTECTION OF PROPERTY RIGHTS

All land is owned by the government. The 1993 Law on Property defines the following types of property: private, state, non-government organizations, cooperative, joint-venture, foreign states, legal entities and citizens, international organizations and mixed private and state. Most housing is state-owned and may not be resold. Turkmenistan adopted a new land code in 2004, addressing farmers' land rights. According to the new land law, citizens may have rights up to three hectares of land but they cannot sell, exchange, or transfer it, except to their children. Based on the law, foreign citizens and stateless persons, foreign states, and companies and international organizations may only lease land. The October 1, 2007 amendments to the Land Code provide for up to 40-year land leases for hotels and recreational facilities in the National Tourism Zone (NTZ). Land and built facilities have to be transferred after the expiry of the contract. According to the Law on Foreign Investment, foreign investments in Turkmenistan are not subject to nationalization and requisition; foreign properties may be confiscated only by a court decision.

The government has enacted laws designed to protect intellectual property rights domestically, but these laws are either arbitrarily implemented or not implemented at all. Among them are the 1993 Law on the Protection of Scientific Research and the 1993 Patent Law.

Also in 1993, the government established the Patent Agency. There is no requirement to register with the Patent Agency, but doing so gives a company exclusive rights to use the registered material and certain tax benefits defined by the Cabinet of Ministers. However, due to significant deficiencies in Turkmenistan's intellectual property protection regime, there is an ongoing review of Turkmenistan's status as a beneficiary country under the U.S. Generalized System of Preferences (GSP) Program. Turkmenistan has been on the SpecialQ1 Watch List since 2000.

The Law on Foreign Investment guarantees the protection of intellectual property of foreign investors, including literary, artistic and scientific works, software, databases, patents and other copyrighted items, but Turkmenistan has yet to adopt more explicitly and comprehensive administrative and civil procedures and criminal penalties for Intellectual Property Rights (IPR) violations. Turkmenistan has not adopted a separate Copyright Law and consequently does not provide any protection to foreign sound recordings or pre-existing works. The 1993 Most Favored Nation Agreement between the United States and Turkmenistan also provides for favorable treatment of copyrighted materials. The agreement envisages Turkmenistan's accession to the Berne Convention of 1971

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for the Protection of Literary and Artistic Works and Creation of a Working Group on Intellectual Property Matters. To date, Turkmenistan has not joined the Berne Convention nor the Geneva Phonograms Convention. It is a challenge to purchase legal recorded material in Turkmenistan. Current border enforcement is weak. As a result, pirated recordings freely cross into Turkmenistan for sale. Additional personnel and training courses are needed for more effective border enforcement. Turkmenistan does not provide for either civil or criminal ex parte search procedures needed for effective anti-piracy enforcement.

Turkmenistan signed the World Intellectual Property Organization's (WIPO) documents on industrial property rights and patent cooperation in 1995. Turkmenistan has also joined the Eurasian Patent Organization that was created as part of the WIPO for the CIS countries. Turkmenistan has not signed the 1996 WIPO Copyright Treaty (WCT), WIPO Performances and Phonograms Treaty (WPPT), or WIPO Internet Treaties.

The Copyright Law was enacted as part of Turkmenistan's Civil Code, in force since 2000. The Law defines copyrighted products and the rights of owners of the copyrighted products, and provides their legal protection. However, there is no agency responsible for implementing or enforcing the copyright law. Turkmenistan has not adopted criminal penalties for IPR violations, and currently articles such as videos, cassette tapes, and literature are freely copied and sold. In general, state products increasingly dominate local markets and are well-protected by law enforcement bodies. State products, petroleum and textiles exported from Turkmenistan have been assigned trademarks to protect them in foreign markets.

TRANSPARENCY OF THE REGULATORY SYSTEM

The government does not use transparent policies to foster competition and foreign investment. Laws have frequent references to by-laws that are often not publicly available. Most by-laws are passed in the form of presidential decrees. Such decrees are not categorized by subject, which makes it difficult to find relevant cross references. Previously, government officials acted on the president's verbal instructions, rather than written orders or governing legislation. Most often, personal relations with government officials have played a decisive role in determining how and when government regulations are applied.

Bureaucratic procedures are confusing and cumbersome. There is no single body that coordinates registration and activities of domestic and foreign private companies. The government does not generally provide information support to investors, and officials use the lack of information to their personal benefit. Foreign companies may spend months conducting due diligence in Turkmenistan.

A serious impediment to foreign investment is the lack of knowledge

of internationally-recognized business practices and concepts and of English speakers. Good quality English-language material on Turkmenistan legislation is scarce, and there are very few business consultants to assist investors.

There are no standards-setting consortia or organizations besides the Turkmen State Standards (TDS) and the relevant licensing government agency.

There is no independent body for filing complaints. Financial-disclosure requirements are not transparent and consistent with international norms, and government enterprises are not required to publicize financial statements, even to foreign partners. Financial audits are often conducted by local auditors, not internationally recognized firms.

The Law on Petroleum was a partial step toward creating a more transparent policy in the oil and gas sector; it provides a detailed legal framework for conducting oil and gas business. Under this law, three types of licenses can be issued: exploration,

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extraction, and a single exploration and extraction license. Two types of agreements can be signed for oil production: a production sharing agreement and a joint venture agreement. In 2006, the Government indicated it was considering the possibility of allowing joint operations in the gas sector, but no appropriate amendments have been made to that effect.

EFFICIENT CAPITAL MARKETS AND PORTFOLIO INVESTMENT

Turkmenistan's financial system significantly hinders the free flow of financial resources. Most numerous and largest in size are the six state banks: State Bank for Foreign Economic Relations (Vnesheconombank), Dayhanbank, Turkmenbashi Bank, Turkmenistan Bank, Halk Bank, and President Bank. These state banks have narrow specializations-- foreign trade, agriculture, industry, society, savings and mortgages, respectively. Two additional commercial banks, one joint (with Ziraat Bank) Turkmen-Turkish bank, and a branch of the National Bank of Pakistan also operate in Turkmenistan. Total assets of the country's largest bank, Vnesheconombank, are estimated at \$1.3 billion (2006) at the official exchange rate of 5,200 manats per dollar. Assets of the other banks are much smaller.

All banks, including commercial banks, are controlled by the state. Commercial banks are prohibited from providing services to state enterprises.

The U.S. Export Import (EXIM) Bank is not currently considering short and medium-term U.S. export financing for projects in Turkmenistan, although a number of U.S. companies have used EXIM Bank funds or guarantees in the past to finance their exports to Turkmenistan. State banks mostly serve state enterprises and allocate credit on subsidized terms to the state enterprises. Foreign investors are only able to get credit on the local market through EBRD equity loans.

There is no capital market in Turkmenistan, although the 1993 Law on Securities and Stock Exchanges outlines the main principles for issuing, selling and circulating securities. The Law on Corporations further provides for issuance of common and preferred stock, and bonds and convertible securities in Turkmenistan, but in the absence of a stock exchange or investment company, there is no market for securities. In the mid 1990's, the government turned some nearly bankrupt state-run enterprises into corporations. Foreign entities may theoretically purchase shares in these companies, but have shown no interest in so doing.

POLITICAL VIOLENCE

Saparmyrat Niyazov, the president since Turkmenistan received its independence in 1991, died in December 2006. Since Gurbanguly Berdimuhamedov's ascension to the presidency in February 2007, Turkmenistan's political system has showed no sign of immediate change, though promises to reform the social sector -- education,

health and agriculture -- are promising.

The politically repressive but stable existence Turkmenistan experienced in its first ten years of independence halted in November 2002 with an armed attack against President Niyazov's motorcade in central Ashgabat. The regime reacted with a series of mass arrests, show trials and purges of government ministries. There were credible reports that torture was employed to gain signed confessions. Authorities violated the Vienna Convention for diplomatic immunity when they raided the Uzbekistan Ambassador's compound in December 2002.

The government prohibits political opposition by banning opposition parties and requiring registration for all organizations. There have been no incidents involving politically-motivated damage to projects or installations.

CORRUPTION

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Turkmenistan has legislation to combat corruption, but the laws are ineffective and corruption is rampant. The non-transparency of the economic system provides fertile soil for corruption, and the common assumption is that nearly any decision desired can be obtained for a price. U.S. firms have identified widespread government corruption, usually in the form of bribe requests, as an obstacle to investment and business throughout all economic sectors and regions. It is most pervasive in the areas of government procurement and performance requirements. There are several known cases of local businessmen being arrested without charges until they pay local officials for their release.

Turkmenistan joined the UN Convention against Corruption in March 2005. The non-government organization Transparency International, ranked Turkmenistan 162 among 179 countries in the world in its Corruption Perceptions Index for 2007. President Berdimuhamedov has restructured some offices in charge of expenditures that appear to be geared toward rooting out corruption. Formally, the Ministry of Internal Affairs, the Ministry of National Security, and the General Prosecutor's Office are responsible for combating corruption. President Berdimuhamedov has repeatedly stated that corruption will not be tolerated. Berdimuhamedov replaced the Minister of Internal Affairs at an April 2007 session of the Cabinet of Ministers and directed the incoming minister to wipe out corruption. In contrast to official corruption, violent criminal organizations are largely non-existent in Turkmenistan.

BILATERAL INVESTMENT AGREEMENTS

The Governments of Turkmenistan and the United States began negotiations on a bilateral investment treaty after 1991, but talks were suspended in early 1994. The Government of Turkmenistan expressed interest in renewing the talks in 1998, but negotiations have not recommenced. The United States government considers the Convention with the Union of Soviet Socialist Republics on Matters of Taxation, which entered into force in 1976, to continue to be in effect and applicable between the United States and Turkmenistan. There have been no discussions on a new dual taxation treaty.

Turkmenistan has signed bilateral investment agreements with Turkey, China, France, Malaysia, Pakistan, Romania, Slovakia, the United Kingdom, Northern Ireland, Egypt, India, Uzbekistan, Iran, Armenia, Georgia, Germany, Ukraine, and the United Arab Emirates.

In 2006, the European Union decided to withdraw from negotiations on a trade agreement with Turkmenistan, citing the country's poor human-rights record.

OPIC AND OTHER INVESTMENT INSURANCE PROGRAMS

Turkmenistan signed an Investment Incentive Agreement with the U.S. government in 1992, but there has been no investment insurance, investment guarantees or financing provided by the Overseas Private Investment Corporation (OPIC) for Turkmenistan.

LABOR

Labor matters are governed by the Labor Code of Turkmenistan, the Law on Leaves of Absence, the Law on Occupational Safety, the Law on Pensions and a number of regulations approved by presidential resolutions. Turkmenistan joined the International Labor Organization in 1993.

Unemployment and underemployment are major problems. The last official survey, conducted in 1995, implausibly estimated unemployment at 3% of the labor force. Current unofficial estimates are above 50%.

Since 1997, Turkmenistan has introduced "labor exchanges" or employment offices, operating as self-sustaining entities under local government offices. Turkmenistan's regulations require that

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all vacancies be posted via such labor offices. Although most vacancies in the labor exchanges' databases are low-skilled jobs, employment offices have not been an effective tool in reducing unemployment. Finding suitable candidates via these offices is also problematic for international companies. Investors recruit directly, though candidates still pay a nominal fee to the relevant labor exchange. Although the government requires foreign companies to have 70% of the local workforce be local citizens, it has made exceptions for foreign construction companies executing large-scale turnkey projects. Officials are known to request investors to employ their relatives and friends.

The government had greatly weakened Turkmenistan's education system. Under President Niyazov, mandatory secondary education was reduced from 10 to 9 years, further contributing to unemployment. However, in February 2007, Turkmenistan's newly-elected President, Gurbanguly Berdimuhamedov, announced the reinstatement of 10 years' mandatory education starting with the 2007-2008 academic year. The president also increased higher education from two to five years and medical training to six years. After years when teaching of English and other foreign languages had little part in most schools' curricula, President Niyazov in 2006 reinstated mandatory English-language training. The general lack of foreign language learning has hampered the ability of students to study outside Turkmenistan and work with international companies. The adult population of Turkmenistan was relatively well-educated under the Soviet system, but lacked various marketable skills, including foreign languages and computer literacy. The lack of quality educational institutions and the government's unwillingness, until recently, to support technical training has impeded the development of a work force capable of supporting high-tech foreign investment projects. Lack of familiarity with modern technology and business practices has been an additional weakness within the available labor pool, but the recent reforms should begin to address these shortcomings.

The Association of Trade Unions of Turkmenistan -- successor to the Soviet-era system of government-controlled trade unions -- is the only trade union allowed in the country. The Association's unions are divided along both sectoral and regional lines, and all social and economical activities are limited.

The normal workday in Turkmenistan is 8 hours, and the standard workweek is 5 days/40 hours. In practice, many employees are required to work at least half a day on a sixth day. The minimum age for employment of children is 16. In a few heavy industries it is 18. The labor law prohibits 16-18 year-olds from working more than 6 hours a day, and only with parental and trade union permission. Health and safety regulations exist, but are commonly not enforced. Foreigners with government permission to reside in Turkmenistan may work, but are subject to the same labor regulations as citizens unless otherwise specified by law.

FOREIGN TRADE ZONES/FREE PORTS

The Law on Economic Zones for Free Enterprise was enacted in 1993. The law guarantees the rights of businesses -- foreign and domestic -- to operate in these zones without profit ceilings. The law forbids nationalization of enterprises operating in the zones and discrimination against foreign investors. Other rights guaranteed

include:

- Preferential tax status, including exemption from profit tax if profits are reinvested in export-oriented, advanced technology enterprises;
- Repatriation of after-tax profits;
- Exemption from customs duties, except on product of foreign origin;
- Export of products;
- Setting product prices.

There are ten such zones in Turkmenistan: Mary-Bayramaly, Ekerem-Hazar, Turkmenabat-Seydi, Bakharly-Serdar, Ashgabat-Anew,

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Ashgabat-Abadan, Saragt, Guneshli, Ashgabat International Airport, and Dashoguz Airport. The zones have not been successful in drawing increased economic activity. Despite the legal guarantees, the government continues to meddle in business decisions even for firms located in these zones. The zones have not been financially supported by the government and lack infrastructure, such as advanced telecommunications, to attract businesses. The infrastructure at Ashgabat International Airport is more developed and has modern cargo transit facilities.

In July 2007, President Berdimuhamedov announced the creation of the Avaza free tourist zone along 16 kilometers of the Caspian Sea coast. The Ministry of Economy and Finance (MOEF) promised exemption from MOEF registration fees and Value Added Tax (VAT) to contracting and management companies, full convertibility of all manat-denominated operations earnings into hard currency for amortization of foreign loans, payment for construction work or services, purchase of raw materials, equipment, and goods. This zone will have a special regime for making cash payments and overseas electronic transfers, and equipment and materials used in facility construction or management will be exempt from calibration fees in the zone. Amendments to the Land Code passed in October 2007 include a provision for 40-year land leases for construction of tourism facilities and five-year leases for retail and services points, warehouses and car parking lots. Tourism-related services such as catering and hotels -- but not casinos -- are also granted VAT exemption. Construction equipment used in the Zone will not be subject to the one percent property tax. In addition, the government will not levy income taxes related to tourist accommodations and catering for the first 15 years.

FOREIGN DIRECT INVESTMENT STATISTICS

State data on many economic indicators, including Foreign Direct Investment (FDI) remain unreliable and mostly unavailable. However, according to various independent analysts, most foreign investment is directed toward the country's oil and gas sector. Such investments include three onshore Production Sharing Agreements (PSAs): the Nebitdag project operated by Burren Energy UK, the Khazar project operated jointly by the Turkmenneft state concern and Mitro International of Austria, and a PSA signed with the China National Petroleum Corporation (CNPC) in 2007. The remaining three PSAs are offshore operations, including the Cheleken project operated by Dragon Oil of the United Arab Emirates, the Block-1 project operated by Petronas of Malaysia and the Blocks 11, 12 project operated jointly by Maersk Oil of Denmark and Wintershall of Germany.

By early 2007, Dragon Oil has invested a total of \$618 million. It has estimated that its investment for 2007 will total about \$250 million and its investment in 2008 will be \$500 million. Petronas' total investment by the beginning of 2007 amounted to \$705 million. Petronas intends to invest \$600 million in 2007. Burren and Mitro have invested \$450 and \$225 million respectively. Although, these investment statistics are incomplete, they represent at least a two-fold increase over the \$418 million foreign investment figure in 2005 (The EBRD Transition Report 2007). Other potential investors, including Chevron, BP, Lukoil and ConocoPhillips, are holding high-level discussions with the Government of Turkmenistan.

END TEXT.
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